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INVESTMENT STRATEGY OUTLOOK

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The unwinding of the technology euphoria of 1998-1999 continued in the March quarter and also spilled over into other high valuation sectors and beyond. Most major indices were down significantly: the S&P 500, 12%; the Nasdaq, 25%; and the benchmark Russell 2000, 6.7%. Your portfolio continued to hold up very well in this environment, relative to the market, reflecting investors' increased attention to valuation. Later in this report, we will highlight a few of your portfolio holdings and why we like them over the coming years.

Buying Opportunity?

Over the past few months we have often been asked if it's a "buying opportunity" for many of the battered technology stocks. With most "blue chip" tech stocks (and the Nasdaq) down over 65% from a year ago, there is a natural inclination to think they must be cheap. From a long-term historical perspective, however, one cannot make this case. Valuation levels of the major technology stocks and indices remain significantly higher than past market bottoms. This doesn't necessarily condemn these stocks to further declines, it simply means that when sentiment was poor in the past, the stocks hit much lower levels. It may be different this time, but recall, fifteen months ago the "new economy" stocks were supposed to be "different," and valuations didn't matter. The fact that there remains so much buying interest in these types of companies also speaks volumes about investor sentiment. February was the first month, since the Russian debt crisis in 1998, in which so-called growth funds experienced net outflows. The fact that 18 of the 20 biggest daily percentage gains in Nasdaq history occurred in the past twelve months, with each rally failing and each low being lower, tells us that investors are still "buying the dips" in order to capture the rebound. This is classic bear market behavior. History, unfortunately, has not been kind to leaders of the previous up cycle; usually the next up cycle has new leadership.

There is nothing magical or mystical about why leadership changes. It is a function of the capital cycle. Typically "hot" areas attract new capital, eventually leading to overcapacity and, ultimately, destructive pricing. Public equity values fall, private funding dries up and a fairly lengthy period of rationalization and consolidation usually ensues. Eventually this leads to another up cycle. The fact that we are just now seeing the layoffs at companies such as Cisco, Lucent and Solectron tells us that the rebound may be a way off.

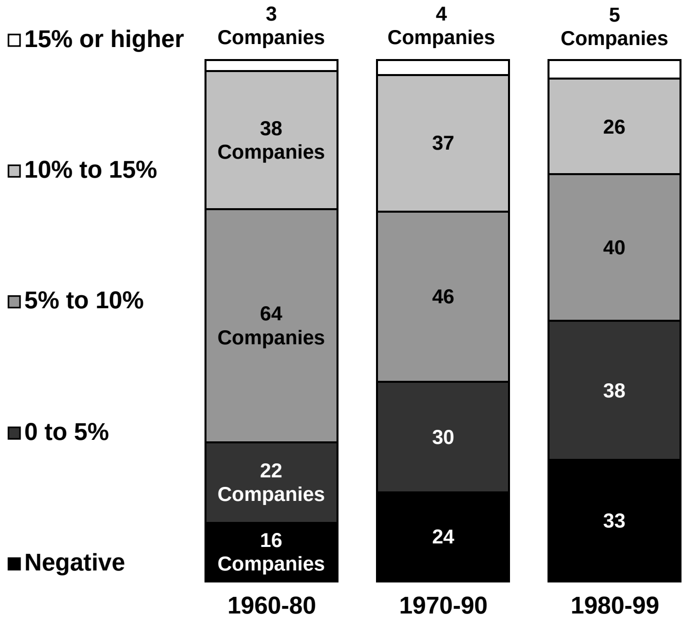
As with all market downturns, however, wonderful investment opportunities usually present themselves; this time should be no different. We are currently buying a few new companies and adding to some existing holdings that look particularly attractive.

"The 15% Delusion"

In the February 5th issue of *Fortune*, there was an interesting article entitled, "The 15% Delusion," written by the highly regarded journalist, Carol Loomis. Ms. Loomis points out how common it is for corporate CEOs to promise "15% growth." In the case of technology CEOs, it's "20-25%." Wall Street analysts and investment bankers have come to believe that this kind of growth rate is to be expected of "good" companies. Options and other compensation programs have been built around this goal. Investors in recent years have also come to expect this of their stocks. The article discusses just how difficult 15% growth really is over a sustained period of time. We have reprinted the results, depicted in the bar chart that follows.

Fortune analyzed three roughly twenty-year periods (1960-1980, 1970-1990, and 1980-1999). At the beginning of each period they studied 150 profitable blue chip companies and measured their long-term growth rates. In the first time segment, 1960-1980, only three companies achieved 15% growth or higher (Standard Oil, Philip Morris and Boeing). The 1970-1990 period saw four companies exceed this goal (Boeing, Philip Morris, Merck and PPG Industries). During the last segment, 1980-1999, five out of 150 achieved 15% growth or better (Fannie Mae, UAL, Philip Morris, Merck and Abbott Labs). In the respective time periods, 16, 24 and 33 companies actually had negative growth! The typical growth rate was 0-10%. We have often discussed the fact that the S&P 500 earnings growth has averaged about 6% over long periods of time. The article confirms this number. Studies by Ibbotson and others suggest smaller companies have grown earnings at approximately 8% per year. Our own studies suggest that over the years (since 1980), your portfolio companies have grown their earnings, on average, at 10-12%.

Number of Companies Whose Earnings-Per-Share Growth Rate was...



Ms. Loomis touches on why managements promise 15%. She suggests hubris, naivete or some sort of feeling that it is good for their stock. It may simply be that managements are accustomed to being above-average and thus naturally set above-average goals. Boards of directors certainly like to believe they've hired superior talent. These managers are paid like rock stars so it follows that they would set high targets. For many companies, compensation plans are tied to unrealistic goals, which fosters all sorts of bad behavior. Every day we read of another Cendant, Lucent or Xerox situation...companies, fanatical about "hitting the numbers," but instead creating an environment where managers interested in self-preservation and/or greed take shortcuts.

Wall Street has fed the 15% delusion. Analysts publish long-term growth rate expectations of 15% as if it were a common outcome. Investment bankers often convince CEOs that they need to do deals to achieve their long-term growth targets. There is a large body of evidence that shows that most of these deals are uneconomic. Investors have bought into the 15% delusion because they achieved this kind of gain over a relatively short period of time. Virtually every long term study of stock prices shows a 10% rate of return as the norm. We believe a consistently applied value-oriented investment approach can do somewhat better than 10%. Our long-term track record supports this.

As is our custom with the April letter, we would like to highlight a few of your portfolio companies.

AptarGroup

AptarGroup is the one of the world's leading producers of dispensing caps and closures for several major end markets: fragrance and cosmetics; personal care; pharmaceutical; household; and food. It is a $900 million company with roots back into the 1940s and boasts such customers as Coca-Cola, Gillette, Glaxo, L'Oreal and Proctor & Gamble. While the packaging industry is mature, AptarGroup's niche in dispensing systems has a healthy internal growth rate of 7-8%. The Company has grown more rapidly than this historically because of market share gains and modest, consolidating acquisitions. The major attraction to this company is the steady, recurring nature of its business. Perfume, shampoo, oven cleaner, liquid soup, medicine and drinks are all consumed. The Pharmaceutical opportunity could be interesting given the attractiveness of nasal-delivered metered doses, an AptarGroup specialty. The Company generates nearly two-thirds of its earnings from Europe and has nice growth opportunities in the United States and the developing world.

Although caps and closures seem mundane, there is actually a fair amount of complexity in the pump designs. Precision molding and high-speed assembly, on a worldwide scale, are also necessary. The Company drives a consistent return-on-capital of approximately 13%, well in excess of its cost of capital. Moreover, we have known and trusted the management team for over five years. Our analyst says that you could eat your dinner off the floor of AptarGroup's plants!

We like the stock because of its defensive characteristics, good balance sheet, and reasonable valuation. It is 15 times and 13.7 times 2001 and 2002 estimates, respectively. Risks include currency fluctuations and new product cycles from the major OEMs.

H&R Block

H&R Block's core business is widely recognized as the country's leading tax preparer. It is a great brand name and a dominant franchise. The core business makes up 65% of the Company's revenues and 70% of its pre-tax income. The Company serves one of every seven tax filers. Block is generally able to add to its number of clients served by 2-3% every year, while increasing its price/mix equation by an incremental 5-7%. This results in healthy revenue growth of 7-10%, with even greater earnings and cash flow growth. Additionally, for every $1 of revenue generated in the tax preparation business, $0.14- $0.15 is brought to the bottom-line, which is roughly twice the level of profitability compared to the average S&P 500 company. On a return-on-capital basis, Block achieves a 30% level, which is extraordinary. The complexity of tax regulations should continue to drive steady demand for Block's core tax services.

We made our original investment in Block last spring after the Company pre-announced that it had missed its all-important fourth quarter (ending with last April's tax season). Wall Street appeared to overreact, driving the stock below the intrinsic value of the core tax business. While we are not enamored of the rest of Block's businesses due to above-average volatility, they do fit nicely from a strategic standpoint. Option One is a leading mortgage originator and servicer to middle and lower middle-class consumers. It has an enviable long-term track record of safe lending, although not immune to economically induced credit concerns. H&R Block Financial (formerly Olde Discount), provides brokerage services to the masses and is Block's vehicle for cross-selling tax, mortgage and financial services. Only time will tell whether these are smart strategic pieces to the Block story, but we cannot argue with the logic.

Although the stock has appreciated significantly over the past year, our analyst believes the intrinsic value to the Company is at least 25% higher. The stock currently trades at 17.5 times and 15.1 times 2001 and 2002 estimates, respectively. Anecdotally, the "Oracle of Omaha," Warren Buffett, recently filed a 13F showing an 8% position in the stock.

CenturyTel

CenturyTel is a local telephone company, with nearly $2 billion in revenue, serving small markets (one of their largest markets is Eagle River, Wisconsin). Because CenturyTel is classified by the FCC as a rural carrier, it is exempted from several of the onerous regulations brought about by the Telecommunications Act of 1996. Furthermore, its less densely populated service territory is not on the radar screen of the "Giant Bells". This translates into above-average profitability for the Company. Additionally, as the large operators seek to rationalize their networks, they have divested rural properties. Over the years, CenturyTel has been a buyer of these properties. The Company has established a track record of enhancing the value of these acquisitions. This external growth, along with basic line growth and new services, as described below, gives CenturyTel a healthy outlook for the next several years.

Within its wireline segment, which generates 77% of revenues, CenturyTel has been able to sell additional services (caller ID, voice mail, second line, etc.) into its established customer base. Recent acquisitions give the Company the opportunity to sell these ancillary services into a significantly under-penetrated customer base. Newer service offerings include internet dial-up and digital subscriber line

(DSL) service. Within the wireless segment (23% of revenues), CenturyTel does face meaningful competition - particularly national players such as AT&T Wireless and Sprint PCS. We think management's intense focus on its service territory and the unit's above-average margins provides some protection against these competitive forces.

With a price/cash EPS ratio of 13.0 and an EBITDA margin of 51% in a very stable business franchise, we find CenturyTel to be an attractive stock in either a "normal" or turbulent stock market.

Delphi Financial Group

Despite being a $600 million company, Delphi is somewhat misunderstood and significantly under-followed. We have recently beefed-up our holding of the Company as a result of its current low valuation and high insider ownership (33%). Delphi is a holding company with two major insurance subsidiaries. The first is Reliance Standard, a life and health insurance company, and the second is Safety National, an excess worker's compensation insurance operation. Both insurance companies are solidly profitable, have good management and have consistently upstreamed dividends to the holding company. Historically, Delphi management earned very high returns at the holding company level; a fact, ironically, that disturbed Wall Street. They assumed that these good returns meant high risk, even though the Company established their record in good and bad markets.

This is where the story becomes interesting. Delphi management, frustrated with the stock's low public valuation and poor sponsorship by Wall Street, announced that they were dismantling the holding company structure. They planned to reduce debt and run a "plain vanilla" investment portfolio and let the market value their two outstanding insurance operations on their own merits. Investors rewarded this announcement with a 25% reduction in the stock! Apparently the reduced earnings estimates, due to lower investment returns, suddenly became meaningful to The Street. The stock move appears to make little sense to us as long term investors. Debt has subsequently been reduced to under 20% of capital and the investment portfolio converted to generic status. Now this solid insurance franchise can be had for less than nine times earnings and approximately one times book value. Finally, management has indicated that they won't wait forever to realize value in this franchise. We would not be surprised to wake up someday to a nice take-over premium.

As a final comment, we are pleased to report that Pat English, our Director of Research, has added the additional title of President.

As always, we are grateful for your support of Fiduciary Management, Inc.